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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Falling Commodity Prices . . .

Sometimes lost in the discussions of international trade issues is the extended decline in prices for those basic commodities which form the principal exports of the developing countries. After peaking in 1980 commodity prices plunged, reaching their recent lows in 1982 (see chart). Global commodity prices (as reflected in the International Monetary Fund's Commodity Price Index) began to recover with the rapid expansion of U.S. economic activity which began in November of that year. In the third quarter of 1984, however, as real U.S. growth eased without a compensating increase in economic activity elsewhere, global commodity prices again began to fall.

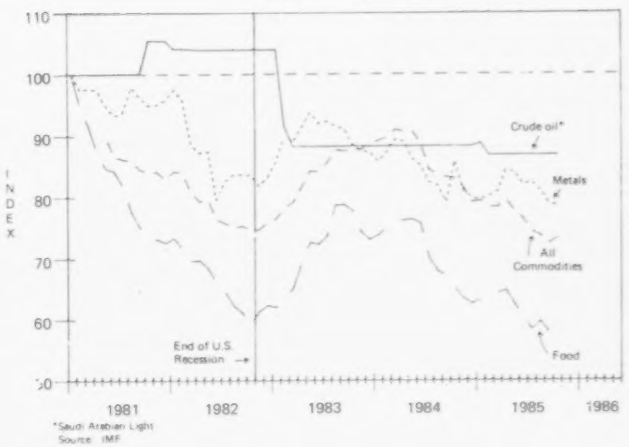
Adding to the economic impact of the decline in demand occasioned by the slowing of economic activity has been the continuation of high debt service costs and a weakening of the trade-weighted dollar. The latter has reduced the purchasing power of those countries whose export earnings are principally in dollars. This has made suppliers, some of whom were encouraged to enter the market or increase production by the skyrocketing prices in the decade of the 1970s, maintain and, where possible, increase production in spite of falling prices. The results have been an even greater excess of supply over demand, reinforcing the decline in most commodities' prices.

The price decline has been consistent through the major commodity categories. Food prices, for example, reflecting excellent harvests in recent years fell by 13.7 percent between the third quarter of 1984 and the third quarter of 1985 and are six percent below their low point in 1982. And prices of beverages (coffee, tea, cocoa) and agricultural raw materials averaged 19 percent and 14 percent respectively below year earlier levels.

. . . Reflect Excess Supply . . .

Oil prices, too, reflect the current malaise in commodity prices. In spite of the strenuous efforts of OPEC, oil prices now respond to market forces. One major reason for this has been the entry into the market of some substantial oil-producing countries which have opted not to join OPEC, thus undermining the cartel's efforts to control world supplies. Even the Saudi Arabians, the key oil producers, have recently abandoned efforts to hold the price line through production cutbacks and instead have chosen to increase output. Further, they have developed bilateral agreements with favored clients at negotiated prices. These deals have undercut the open markets and, as a result have put downward pressure on other crude producers and refiners.

SELECTED COMMODITY PRICE INDEXES
(JANUARY 1981 = 100)



Through the end of November, spot prices for all OPEC crudes averaged $26.60 per barrel—3½ percent below their levels for the same period in 1984. Saudi Arabian light, the so-called benchmark crude, has averaged $27.50 per barrel this year, two percent below last year's level. Once winter demand fades, spot crude prices may fall even further.

Of all the major categories, metal prices have been the most depressed. In fact, metal prices have benefited less from the current economic upswing than most other commodity categories; last year metal prices fell back below their 1982 low point. The weakness in metals prices owes much to changes in technology in recent years as well as an overall secular decline in heavy construction and machine building. Plastics and other materials have replaced metals in many instances. In spite of strenuous

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efforts by groups of metal producers to sustain stable prices through holding huge buffer stocks, declining demand for metal reflecting both a slowing of cyclical economic activity and technological change has forced prices down.

Illustrative of these problems is the crisis in the tin industry. The International Tin Council (ITC) has been unable to meet its contractional obligations, resulting in a suspension of tin trading on the London Metal Exchange on October 24. This event called into question the reliability of the present system of international metal commodities trade and, besides tin, is affecting copper, zinc, aluminum, lead and nickel. In the presence of large inventories of most of these metals, uncertainty as to the financial viability of existing sales and futures contracts has recently forced world prices markedly lower. Indeed, in the case of tin there may be as much as 340 thousand metric tons in world inventories against an annual average demand of perhaps 190 thousand metric tons—nearly two years' supply.

. . . And Sluggish Demand

Several other metals show a similar excess of supply over demand. What is more, the problems of the metal producers are being echoed in other cartels which aim at sustaining commodity prices through agreements to buy up excess production. In an era of high interest rates, such inventories become prohibitively expensive—as the problems of the ITC show. If the tin cartel falls, others may disappear as well, leading to freer trade in commodities in

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/4/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	182.449	+ 2.838	+17.510
Loans to Depository Inst.	1.573	− 2.709	− 2.780
Float	1.214	− .044	+ .701
Total Reserve Bank Credit	199.319	+ .472	+18.397
Treasury Deposits with Federal Reserve Banks	2.258	− .329	− .328
Currency in Circulation	193.745	+ 1.995	+14.016
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	127.174	+ .623	+ 6.738
	12/4/85		
Member Bank Reserves:			
Total Reserves Held	45.244	+ .634	+ 6.280
Excess (Deficiency)	1.084	+ .190	+ .170
Net Borrowed Reserves	1.341	+ 1.579	+ 1.493
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (11/25/85)	621.0	+ 7.3‡	+ 11.2‡
M2 (October '85)	2,533.3	+ 6.9	+ 9.2
M3 (October '85)	3,177.2	+ 7.9	+ 8.6
Domestic Nonfinancial Debt (2nd Q'85)	6,317.3	+ 12.2	+ 13.6

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 12/6/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.26%	7.32%	7.36%
* Federal Agencies	7.50	7.52	7.54
* Municipal Notes—High Grade (46% Taxable Equivalent)	10.00	10.37	10.93
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.97	8.00	7.65

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.88%	Jan.	7.90%
15- 29 days	7.89	Feb.	7.85
30- 59 days	7.90	Mar.	7.80
60- 89 days	7.90	Apr.	7.75
90-179 days	7.82	May	7.70
180-239 days	7.70	Jun.	7.68
240-270 days	7.70		

‡Industrial Paper—Prime		†Federal Funds	
30- 89 days	7.80%	Effective Rate	7.94%
90-120 days	7.75		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'85	$ 3,916	$ 3,853	$ 3,695
Gross National Product (1972 Dollars)*	3rd Q'85	$ 1,689	$ 1,671	$ 1,645
Percent Change, Annual Rate	3rd Q'85	4.3	1.9	1.6
Change in Consumer Prices*	Oct '85	3.6%	2.4%	3.6%
Change in Producer Prices*	Oct '85	10.8%	− 7.2%	− 1.2%
Civilian Employment (Thousands of Persons) †	Nov '85n	107,927	107,867	105,932
Unemployment as % of Civilian Labor Force †	Nov '85n	7.0%	7.1%	7.1%
Personal Income*	Oct '85	$ 3,221	$ 3,207	$ 3,079
Leading Indicators Composite Index (1967=100)†	Oct '85n	171.1	170.6r	164.2
Industrial Production Index (1977=100) †	Oct '85	124.9	124.9	122.7
Net Change in Consumer Installment Credit †	Sep '85	$ 10.63	$ 6.31	$ 4.98
U.S. Merchandise Trade Balance †	Oct '85	−$ 11.45	−$ 15.55	−$ 9.65
Plant and Equipment Expenditures*	4th Q'85	$387.40(a)	$389.54(a)	$368.29
Private Housing Starts (Thousands of Units)*	Oct '85	1,760	1,589	1,564
New Construction Expenditures*	Oct '85n	$ 347.8	$ 346.1r	$ 318.2
Total Business Inventories †	Sep '85	$ 579.5	$ 578.2	$ 565.5
Total Business Sales †	Sep '85	$ 428.5	$ 430.4	$ 412.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

general. In fact, the age of commodity cartels, which afforded high and stable prices to the developing countries in the postwar period, may have ended due to the high costs of holding stockpiles in the lower growth era of the 1980s.

The implications of falling commodity prices for the global economy—industrial and developing countries alike—are important. Clearly a fall in the price of basic commodities is deflationary. Lower cost inputs will lead to lower prices, benefiting consumers. Since transactions for many of these commodities are conducted in dollars, the recent decline in the value of the dollar will drive prices down even further in terms of many foreign currencies. This will stimulate economic growth, particularly in the other industrial countries, and improve their competitive position. Thus, while the U.S. will benefit to some degree from declining commodity prices, our trading partners may well benefit more.

The developing countries, many of which are highly dependent upon exports of a single (or a few) basic commodities, may see their foreign exchange earnings suffer further erosion as the dollar eases and demand for commodities remain sluggish. This will impose additional burdens on them. They are already being severely tested by their present debt service obligations, and the need to pay for imports. What is more, the new orientation toward growth rather than austerity for the high-debt developing countries will, at least at first, call for higher debt service costs, imposing even greater burdens on export earnings.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (11/20/85)	156,908	– 114	– 2,707
New York City (11/27/85)	33,458	– 310	– 490
Commercial Paper (11/27/85)	290,805	– 8	+52,697

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/20/85)	254,340	+ 814	+ 3,901
New York City (11/27/85)	59,236	– 169	– 4,220

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/20/85)	706,680	+ 8,854	+ 60,229
New York City (11/27/85)	157,192	– 2,364	+ 14,488

Financial Markets

	Friday 12/6/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.48%	+ .09	– 1.22
180-Day Bills†	7.69	+ .05	– 1.41
Longest Bills†	7.88	+ .04	– 1.72
Recent Issues:			
8 1/2s 11/30/87	8.46	– .03	
9 3/8s 9/30/89	9.00	+ .05	
9 1/2s 11/15/95	9.63	+ .04	
9 7/8s 11/15/15	9.89	+ .03	
Municipals:			
Bond Buyer–20 Bond Index* (12/5/85)	8.54%	+ .03	– 1.41
Blue List Total ($ Million)	$2,338	+$ 305	+ $ 453
30-Day Visible Supply ($ Million)	$5,360	–$2,352	+ $3,648
Total	$7,698	–$2,047	+ $4,101
Corporates:			
Moody's Aa Composite (12/5/85)	10.92%	– .05	– 1.63
30-Day Visible Supply ($ Million)	$1,580	–$ 578	+ $ 100
Stocks:			
Dow-Jones Averages:			
Industrials	1,477.18	+ 5.05	+ 313.97
Transportation	693.59	+ 3.28	+ 170.89
Utilities	165.57	+ 1.54	+ 20.92
65 Stocks	591.96	+ 2.74	+ 124.18
Standard and Poor's 500 Stocks	202.99	+ .82	+ 40.73
N.Y.S.E. Composite Index	116.99	+ .44	+ 23.47
N.Y.S.E. Avg. Daily Vol. for Week (000's)	135,032	+24,184	+ 46,256

* 46% Taxable equivalent 15.81%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 12/6/85	Week Ago
Overnight	8.00%	7.88%
1 month	8.19	8.06
3 month	8.13	8.06
6 month	8.13	8.06
1 year	8.31	8.19
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	9.50%	9.46%
Long Term (7 to 15 yrs.)	10.00	10.03

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/6/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01948	51.3400
Canada	.7165	1.3956
Denmark	.1094	9.1425
France	.1299	7.7000
Germany	.3962	2.5240
Italy	.0005806	1722.50
Japan	.004917	203.38
Mexico	.002107	474.50
Netherlands	.3521	2.8405
Switzerland	.4753	2.1040
U.K.	1.4765	.6773

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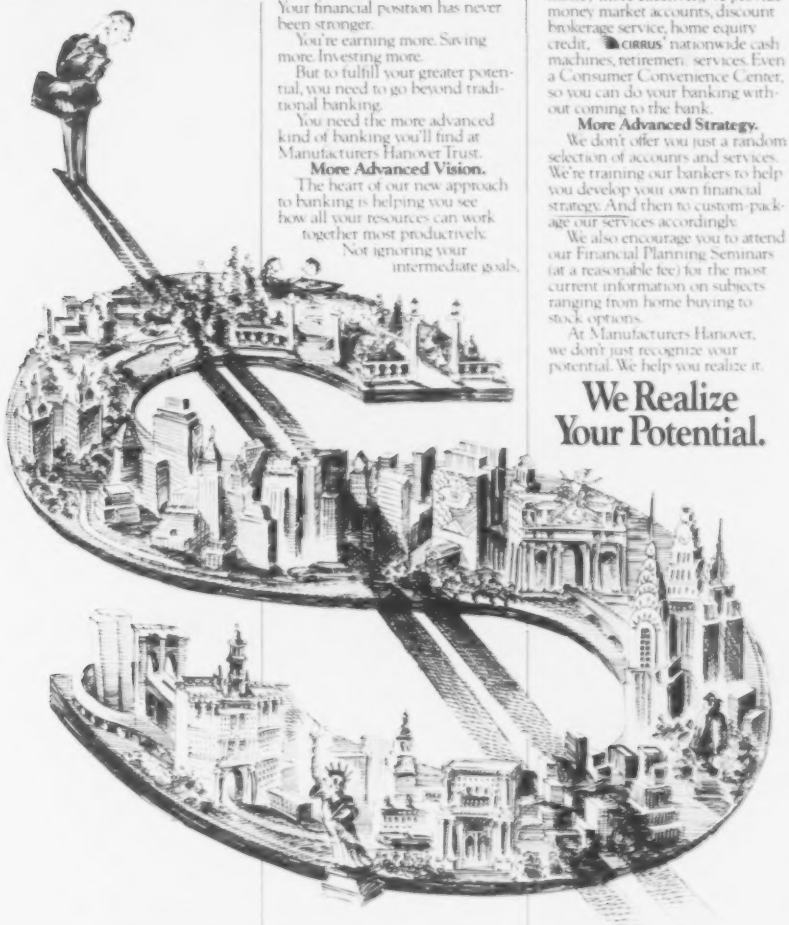

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4520 EAST-WEST HWY., SUITE 80
WASHINGTON, DC 20014